No. 977

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Supreme Court of the United States

OCTOBER TERM, 1940.

MARJORIE FLEMING LLOYD-SMITH,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

JOHN P. OHL,
CHARLES C. PARLIN,
JAMES A. FOWLER, JR.,
Counsel for Petitioner.

Pandick Press, Inc., 22 Thames St., New York, U. S. A.

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COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Supreme Court of the United States:

The petitioner, Marjorie Fleming Lloyd-Smith, by her counsel, prays that a writ of certiorari be issued to review the judgment of the United States Circuit Court of Appeals for the Second Circuit entered in the above-entitled cause on January 22, 1941.

Opinions Below.

This cause originated by the filing of a petition in the United States Board of Tax Appeals to review the determination of the Commissioner of Internal Revenue that there was a deficiency in the petitioner's income tax for the calendar year 1933. The opinion of the Board of Tax Appeals redetermining the deficiency is reported in 40 B. T. A. 214 (Record, p. 18).

The petitioner appealed from that part of the decision of the Board of Tax Appeals adverse to her to the Circuit

Court of Appeals for the Second Circuit. The opinion of the Circuit Court of Appeals is reported in 116 F. (2d) 642 (R. 66).

Jurisdiction.

The judgment of the Circuit Court of Appeals was entered on January 22, 1941 (R. 73). The jurisdiction of this Court is invoked under Section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, §347).

Question Presented.

The question presented is, what was the tax "cost" of the $70,000 principal amount two-year unsecured note of Jorwil Corporation which was sold by petitioner at par in 1933.

The amount of "cost" to be allocated to the said note depends upon whether it was "other property" within the meaning of Section 113 (a) (6) of the Revenue Act of 1932, or a "security" within the meaning of Section 112 (b) (5) of said Revenue Act.

Statute and Regulations Involved.

The relevant portions of the Revenue Act of 1932 and Regulations 77 are set forth in Appendix A.

Statement of Facts.

Sale of Note.

The note in question was sold by petitioner in 1933 to Roosevelt & Sons, a New York banking firm, at par. Petitioner claims a tax cost basis of $386,458 for this note, and thus

a loss on its sale of $316,458. The Commissioner of Internal Revenue contends that the tax cost basis of the note was $70,000, and therefore no loss was realized upon its sale (R. 27, 59, 67).

Acquisition of Note.

Petitioner organized Jorwil Corporation, a New York corporation, in 1932, and conveyed to it certain of her assets located in California. In exchange for those assets she received all of its capital stock and its two-year 6% note in the principal amount of $303,000. Subsequently, the $303,000 note was split into two notes, one for $233,000 and the other for $70,000. The latter is the note involved in the instant proceeding (R. 23, 27, 29, 67).

"Cost" of Note.

It is not disputed that the cost to petitioner of the properties transferred to Jorwil Corporation was $2,636,778.49 (R. 27, 67), and, since the transfer was a tax-free controlled exchange under Section 112 (b) (5) of the Revenue Act of 1932, that the said cost basis of $2,636,778.49 becomes the cost basis of the property acquired upon the exchange (R. 67-69).

The only matter in dispute is the proportion of the aggregate cost of $2,636,778.49 which is to be allocated to the note and to the stock, respectively (R. 67).

The Commissioner of Internal Revenue held that the note was "other property", and of the aggregate cost basis of $2,636,778.49 he allocated to the $70,000 note only $70,000, its fair market value at the time of the exchange. This allocation was approved by the Board of Tax Appeals and by the Circuit Court of Appeals (R. 31-33, 67).

Petitioner, on the other hand, claims that the note was a "security" within the meaning of Section 112 (b) (5), and

that the aggregate cost basis of $2,636,778.49 should be allocated between the note and the stock on the basis of their relative fair market values as of the time of the exchange. It is not disputed that if the note was a "security" within said section, the cost to be allocated to the $70,000 note is $386,458.

A summary of the allocations of cost between the Jorwil Corporation notes and the Jorwil Corporation capital stock as held by the Circuit Court of Appeals, and as claimed by the petitioner, is as follows:

	Fair market values at time of issue	Allocation of cost claimed by petitioner	Allocation of cost per opinion below
$ 70,000 note	$ 70,000.00	$ 386,458.00	$ 70,000.00
$233,000 note	233,000.00	1,286,350.89	233,000.00
Capital Stock	174,606.19	963,969.60	2,333,778.49
Total	$477,606.19	$2,636,778.49	$2,636,778.49

(R. 27, 38, 67).

Reasons for the Organization of Jorwil Corporation.

Petitioner in 1927 had signed a guaranty of a $3,000,000 issue of bonds of the Sugar Pine Lumber Company, a California corporation, in which she had a large interest. In 1932 the Lumber Company collapsed. Faced with a threat by one of the groups of bondholders to attach all of her California assets, petitioner decided to remove all of her properties in that State to New York. While she had been advised by counsel that in their opinion she had a legal defense to any action brought on the guaranty as the result of false statements made in the prospectus on which she relied in executing the guaranty, she desired to have all suits brought against her in New York because of the prejudice she was advised would exist in California in favor of the bondholders (R. 21, 23), and

because of the added cost of defending the suits in California.

In view of these facts, all of petitioner's California real estate was transferred to Notram Corporation organized under the laws of New York, and all open accounts receivable, petitioner's stock in Notram Corporation and the stock of all California corporations owned by petitioner were transferred to Jorwil Corporation, likewise organized under New York laws (R. 23).

Petitioner made no attempt to avoid service of process in New York or to impair her ability to respond to any judgment which might be obtained, and suits were ultimately brought by certain of the bondholders in New York on the guaranty. *Bicknell* v. *Lloyd-Smith,* 109 F. (2d) 527 (C. C. A. 2nd, 1940); *Security First National Bank of Los Angeles* v. *Lloyd-Smith,* 284 N. Y. 791 (1940).

Reasons for Granting the Writ.

I. The decision of the Circuit Court of Appeals is in conflict with the decision of the Circuit Court of Appeals for the Ninth Circuit in *Burnham* v. *Commissioner,* 86 F. (2d) 776 (1936), cert. denied, 300 U. S. 683, 57 Sup. Ct. 753, 81 L. Ed. 886 (1937).

The *Burnham* case *supra,* held that an unsecured corporate promissory note, exchanged two years after its issuance, was a "security" within the meaning of the reorganization provisions of the Revenue Act of 1928, whereas the decision below held that the unsecured two-year promissory note of Jorwil Corporation was not a "security" within the meaning of similar provisions of the Revenue Act of 1932.

This case, which was one of those primarily relied upon by the petitioner in its briefs and argument before the

Circuit Court of Appeals, was not even cited in the opinion below.

II. The decision of the Circuit Court of Appeals is contrary to the decision of this Court in *Helvering* v. *Watts,* 296 U. S. 387 (1935).

In the *Watts* case, bonds were held to be "securities" and not "other property" within the meaning of the reorganization sections of the Revenue Act of 1924. The bonds involved matured serially, thirteen per cent of the total falling due in five weeks. Forty per cent of the bonds had due dates of about two years or less, and the average maturity date was about three years and three months. The Jorwil Corporation note, which the court below held to be "other property" and not a "security" under similar provisions of the Revenue Act of 1932, had a maturity exceeding or equal to that of forty per cent of the bonds in the *Watts* case and about two-thirds as long as their average maturity.

III. The decision of the Circuit Court of Appeals, in holding that the doctrine of "continuity of interest" is to be applied in allocating cost basis to obligations received in a tax-free controlled exchange, is an unwarranted extension of the scope of the decisions of this Court applying such doctrine and raises a novel and important question of Federal law which should be settled by this Court.

The doctrine of "continuity of interest" was first enunciated by this Court in *Pinellas Ice & Cold Storage Company* v. *Commissioner,* 287 U. S. 462 (1933); and applied in *Helvering* v. *Minnesota Tea Company,* 296 U. S. 378 (1935); *John A. Nelson Company* v. *Helvering,* 296 U. S. 374 (1935); *LeTulle* v. *Scofield,* 308 U. S. 415 (1940) and *Helvering* v. *Tyng, Helvering* v. *Buchsbaum,* 308 U. S.

527 (1940). The doctrine of "continuity of interest" was applied in these cases to determine whether there had been a tax-free reorganization, as distinguished from a taxable sale.

The only question in the instant case is the proper method of allocating the cost of petitioner's California assets transferred to Jorwil Corporation between the stock and the note of Jorwil Corporation received in exchange therefor. There is no problem of distinguishing a reorganization from a sale and thus no problem of continuity of interest.

IV. The decision of the Circuit Court of Appeals in holding that a two-year corporate note is not a "security" under the tax-free controlled exchange provisions of the Revenue Acts, raises a novel and important question of construction of Federal law which should be settled by this Court.

The term "securities" was not defined in the Revenue Act of 1932 or the Regulations thereunder, nor in any prior Revenue Act or Regulations. In the absence of an express definition, language of a statute is to be read in its natural and common meaning. The natural and common meaning of the term "securities" indisputably comprehends promissory notes and Congress itself has on numerous occasions, in Revenue Acts subsequent to the Revenue Act of 1932, expressly so defined it. Whenever it was intended that the term should have a special or restricted meaning, Congress provided an express definition for the guidance of the taxpayer and the courts.

V. An authoritative determination by this Court of the question whether a promissory note may be a "security" for the purposes of the exchange provisions of the Revenue

Acts is important to a proper administration of the Revenue laws.

At the present time, the Treasury Department is forced to argue both sides of the question. For example, see *Hoagland Corporation* v. *Commissioner,* 42 B. T. A. 13 (appealed by taxpayer September 7, 1940 to C. C. A. 2nd), in which the Treasury Department contended and the Board of Tax Appeals held that a demand promissory note was a security within the meaning of the reorganization provisions of the Revenue Act of 1934. Such uncertainty not only increases greatly the expense of administering the tax laws, but imposes a similar additional burden upon the many taxpayers who have given or received corporate notes in connection with exchanges, recapitalizations and reorganizations.

The question whether a corporate promissory note is a "security" is of continuing importance, for the Revenue Acts subsequent to that of 1932 and the Internal Revenue Code contain provisions identical with those involved in the instant case. The difficulty of the question was adverted to by this Court in *LeTulle* v. *Scofield,* 308 U. S. 415, 420 (1940).

It is submitted that a review by this Court of the instant case would eliminate such doubt and uncertainty, and the resulting burden of litigation, both for the Treasury Department and taxpayers.

Conclusion.

WHEREFORE, for the reasons stated above and discussed more fully in the annexed brief, your petitioner prays that a writ of certiorari be issued out of and under the seal of this honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, to the end that

the above cause may be certified to and reviewed and determined by this Court, as provided in Section 240 of the Judicial Code, as amended, 43 Stat. 938 (U. S. C., Title 28, Section 347), and that the judgment of the said Circuit Court of Appeals in the above-entitled cause, and every part thereof, may be reviewed by this Court, and your petitioner prays for such other and further relief as this Court may deem just and proper.

Respectfully submitted,

JOHN P. OHL,
CHARLES C. PARLIN,
JAMES A. FOWLER, JR.,
Counsel for Petitioner,
63 Wall Street,
New York, N. Y.

Dated: New York, N. Y.,

April 21, 1941.